



Revenue Interim Committee

67th Montana Legislature

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TO: Committee Members

FROM: Jaret Coles, Staff Attorney

RE: Department of the Treasury Guidance on American Rescue Plan Act Tax Provisions

DATE: June 30, 2021

This document is: (1) a summary of legislation enacted during the 2021 legislative session that has contingency language regarding the of the [American Rescue Plan Act](#), Public Law 117-2 (ARPA); and (2) a brief overview of a U.S. Department of the Treasury [Interim Final Rule](#) regarding an offset of a reduction in net tax revenue.

The ARPA specifies two ineligible uses of funds. States and territories may not use ARPA funding to directly or indirectly offset a reduction in net tax revenue due to a change in law from March 3, 2021 through the last day of the fiscal year in which the funds provided have been spent. Additionally, no recipient may use ARPA funding to make a deposit to a pension fund. Consequently, guidance concerning the ARPA is relevant to future decisions of the Legislature and this committee regarding tax policy.

LEGISLATION WITH CONTINGENCY TERMINATION PROVISIONS

Because of uncertainty regarding the ineligible use criteria during the 2021 legislative session, the Legislature provided contingency language in eight bills that have the potential to reduce tax revenue. The enacted legislation with contingency language regarding the ARPA is as follows:

Individual Income Tax and Corporate Income Tax:

1. [House Bill 191](#) (Ch. 476) Revising the residential property tax credit for the elderly; revising the definition of household income; increasing the maximum credit that may be claimed.
2. [House Bill 279](#) (Ch. 480) Revising laws related to the tax credit scholarship program and the innovative educational program; removing the assessment

requirements for qualified education providers; revising limits on scholarship amounts; allowing tax credits earned under the programs to be carried forward; revising the tax credit limit and the aggregate limit of credits under the programs; revising the preapproval process for the tax credit scholarship program; streamlining the donation process for the innovative education program; extending the termination date for the tax credit scholarship program and the innovative educational program.

3. [House Bill 340 \(Ch. 509\)](#) Generally revising the Montana Economic Development Industry Advancement Act film tax incentives; revising the limit on credits claimed.
4. [House Bill 629 \(Ch. 550\)](#) Generally revising taxation to promote new business and economic activity; providing for the creation of an income tax credit to incentivize montana job growth; providing for administration by the department of labor and industry and the department of revenue; providing that the credits be taken against individual income tax and corporate income tax liabilities; providing definitions; providing rulemaking authority; providing appropriations.
5. [Senate Bill 159 \(Ch. 488\)](#) Reducing the top individual income tax rate.

Natural Resource Tax:

6. [House Bill 661 \(Ch. 559\)](#) Revising stripper oil tax laws; revising the tax rates for stripper oil production; providing definitions.

Property Tax:

7. [House Bill 303 \(Ch. 506\)](#) Increasing the class eight business equipment tax exemption; providing a reimbursement to local governments and tax increment financing districts under the entitlement share program, to school districts through guaranteed tax base aid, and to the Montana University system for the loss of revenue; providing a statutory appropriation.
8. [House Bill 663 \(Ch. 560\)](#) Generally revising school funding laws; increasing the GTB multiplier and linking additional increases to revenue generated by marijuana taxes; providing an appropriation.

CONTINGENT TERMINATION LANGUAGE AND THE ROLE OF THE BUDGET DIRECTOR AND THE LEGISLATIVE FINANCE COMMITTEE

With the exception of [House Bill 663](#)¹, the language regarding contingent termination of tax relief provisions for the above referenced legislation is found in the last section of each bill. The language is similar and generally provides that:

- The Legislature intended to provide tax relief while also preventing the loss of federal funds that are available to the state as part of the ARPA.
- The Budget Director is required to continually evaluate whether implementation of the enacted legislation will:
 1. Result in a reduction of funds from the ARPA; or
 2. Require the state to repay or refund money to the federal government pursuant to the ARPA.
- The Budget Director is required to consider guidance from:
 1. The federal government about the ARPA;
 2. Court decisions about the ARPA;
 3. Amendments to the ARPA;
 4. Any information provided by the Montana Attorney General; and
 5. Other relevant information about the ARPA.
- Based on the guidance, if the Budget Director determines that the implementation of a section of the legislation may result in a reduction of funds or repayment, then the Budget Director is required to notify the Legislative Finance Committee (LFC) of the preliminary determination.
- Within 20 days of notification, the LFC is required to provide the Budget Director with any recommendations concerning the preliminary determination.
- After consideration of the guidance and LFC recommendations (which would include an opportunity for public comment), if the Budget Director determines that the implementation of a section of the referenced legislation would **more likely than not** result in a reduction of funds or repayment, then the Budget Director is required to essentially delay any tax relief before the start of the tax year and continually reconsider whether a tax relief provision should be terminated in future tax years. This is done through a series of contingent termination clauses.

¹ Section 3 of [House Bill 663](#) amends 20-9-366(6), MCA, and reduces the guaranteed tax base multiplier "following certification by the budget director of a contingency pursuant to [House Bill No. 303]". As such, the contingency is based on the House Bill 303 contingency.

THE U.S. TREASURY INTERIM FINAL RULE – SUMMARY OF REDUCTION IN NET TAX REVENUE PROVISIONS

If a State or territory uses Fiscal Recovery Funds to offset a reduction in net tax revenue, the State or territory must repay the Treasury an amount equal to the lesser of the amount of the applicable reduction attributable to the impermissible offset and the amount received by the State or territory under the ARPA.² The [Interim Final Rule](#) implements these conditions by establishing a framework to determine the cost of changes in law, regulation, or interpretation that reduce tax revenue and to identify and value the sources of funds that will offset (cover the cost of) any reduction in net tax revenue resulting from the changes. A state is only considered to have used Fiscal Recovery Funds to offset a reduction in net tax revenue resulting from changes in law, regulation, or interpretation if, and to the extent that, the state cannot identify sufficient funds from sources other than the Fiscal Recovery Funds to offset the reduction in net tax revenue.³

The Interim Final Rule recognizes three sources of funds that may offset a reduction in net tax revenue other than Fiscal Recovery Funds—organic growth, increases in revenue (e.g., an increase in a tax rate), and certain cuts in spending. The Interim Final Rule’s approach also incorporates the types of information and modeling already used by States and territories in their own fiscal and budgeting processes.⁴

For purposes of measuring a reduction in net tax revenue, the Interim Final Rule measures actual changes in tax revenue relative to a revenue baseline (baseline). The baseline is calculated as fiscal year 2019 tax revenue indexed for inflation in each year of the covered period, with inflation calculated using the Bureau of Economic Analysis’s Implicit Price Deflator.⁵

Additionally, there is a *de minimis* exception that allows a recipient government to have a reduction in revenue, so long as the reduction does not exceed 1% of the reporting year's baseline.⁶ The Treasury stated:

The *de minimis* level recognizes the inherent challenges and uncertainties that recipient governments face, and thus allows relatively small reductions in tax revenue without consequence. Treasury determined the 1 percent level by assessing the historical effects of state-level tax policy changes in state EITCs implemented to effect policy goals other than reducing net tax revenues. The 1 percent *de minimis* level reflects the

² Dept. of the Treasury, Coronavirus State and Local Fiscal Recovery Funds, 86 Fed. Reg. 26807 (May 17, 2021).

³ *Id.*

⁴ *Id.*

⁵ *Id.* at 26808 and 26819-20 (§ 35.3 definitions of baseline and net reduction in total spending).

⁶ *Id.* at 26823 (§ 35.8(b)(2)).

historical reductions in revenue due to minor changes in state fiscal policies.⁷

There is also an exception contained in the supplemental information providing that a government entity is not required to count revenue losses that are based on an automatic change that is tied to a federal code provision. For example, Montana sets its earned income tax credit (EITC) in section [15-30-2318](#), MCA, at a fixed 3% of the amount of the Federal EITC. This will cause Montana to have an increase in the state EITC payment and a reduction in tax revenue, but since the reduction is based on a federal government action Montana is not required to count the reduction as a tax decrease.⁸

If a recipient government reports covered changes that reduce tax revenue to a degree greater than the *de minimis* amount, has experienced a reduction in net tax revenue, and lacks sufficient revenue from other permissible sources to pay for the entirety of the reduction, then the recipient government will be considered to have used Fiscal Recovery Funds to offset a reduction in net tax revenue, up to the amount that revenue has actually declined. However, the maximum value of reduction in revenue due to covered changes which a recipient government must cover is capped at the difference between the baseline and actual tax revenue.⁹

Lastly, a recipient government may request reconsideration of any amounts identified as subject to recoupment. A reconsideration is based on all relevant facts and circumstances, including information regarding planned spending cuts and budgeting assumptions, prior to a determination that an amount must be repaid.¹⁰

⁷ *Id.* at 26809.

⁸ *Id.* at 26808.

⁹ *Id.* at 26810.

¹⁰ *Id.*